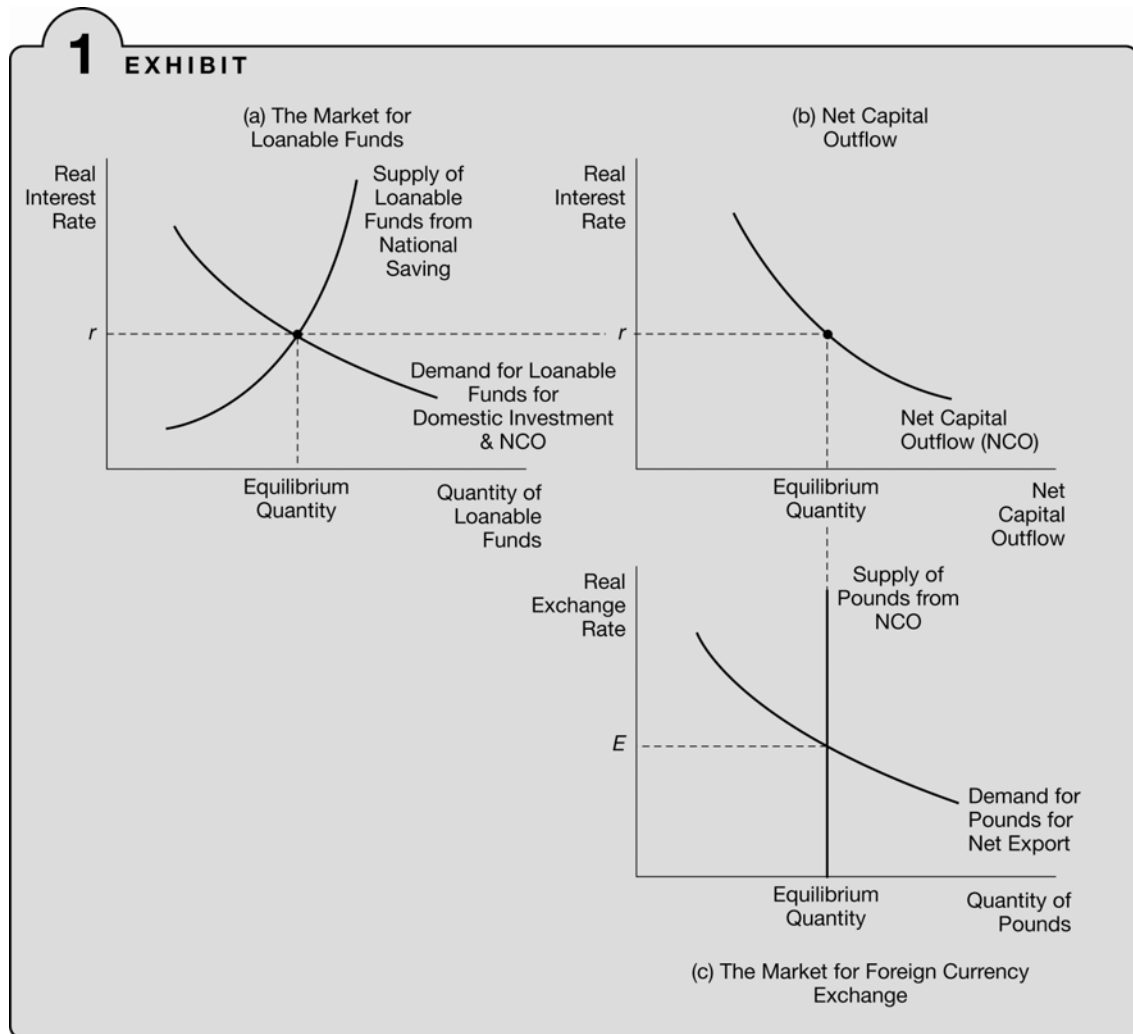


Chapter 32

- This problem is composed of the examples found in the chapter except the direction of the change in each case has been reversed. Use the model described by Exhibit 1 to answer the following questions.



- Suppose the government reduces its budget deficit. Describe the sequence of events in the model by describing the shifts in the curves in Exhibit 1 and discuss the movements in the relevant macroeconomic variables.
- Suppose an existing quota on the importing of Japanese cars is removed. Describe the sequence of events in the model by describing the shifts in the curves in Exhibit 1 and discuss the movements in the relevant macroeconomic variables.
- Suppose there is a sudden inflow of capital into the United Kingdom because the country is believed to be more politically stable than other countries. Describe the sequence of events in the model by describing the shifts in the curves in Exhibit 1 and discuss the movements in the relevant macroeconomic variables.

2. a. Suppose private saving increased at each real interest rate. What would happen to the important macroeconomic variables in our model of an open economy?
 - b. Is there any difference between your answer above and the answer you would write if the government had reduced its deficit? Why?
 - c. Suppose the government were to introduce an investment subsidy that increases domestic investment at each real interest rate. How would this change the important economic variables in the model?
 - d. Compare your answer in part (a) (an increase in saving at each real interest rate) to your answer in part (c) (an increase in domestic investment at each real interest rate). Are there any differences?
3. Suppose that UK consumers' taste for Japanese cars increases. Answer this question using the open economy model from the Japanese perspective.
 - a. What happens to the demand for yen in the foreign currency exchange market?
 - b. What happens to the value of yen in the foreign currency exchange market?
 - c. What happens to Japanese net exports? Why?
 - d. If the Japanese are selling more cars, what must be true about Japanese imports and exports of other items?
 - e. Keeping in mind your answers to (a) through (c), do you think Japan runs an overall trade surplus with the rest of the world because its cars are better built or because of its domestic saving and NCO? Explain.
4. Suppose the United Kingdom is perceived to be politically unstable, which induces capital flight to the United States.
 - a. Describe what happens in the foreign currency exchange market from the perspective of the United Kingdom.
 - b. Describe what happens in the foreign currency exchange market from the perspective of the United States.
 - c. Are your answers to part (a) and (b) above consistent with one another? Why?
 - d. If the economy of United Kingdom is small when compared to the economy of the United States, what should this event do to each country's balance of trade?
 - d. Which country will tend to grow faster in the future? Why?